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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
OAKLAND DIVISION

UNITED STATES OF AMERICA,)	CIVIL ACTION NO. <u>CV 13-2340 SBA</u>
)	
Plaintiff,)	
)	SECOND AMENDED COMPLAINT OF THE
v.)	UNITED STATES OF AMERICA
)	
REUNION MORTGAGE, INC.,)	
)	<u>Jury Trial Demanded</u>
DAVID THAYER, and R. KENT HARVEY)	
)	
Defendants.)	

The United States of America (the “United States” or the “Government”), by its attorney, Melinda Haag, United States Attorney for the Northern District of California, brings this action against Reunion Mortgage, Inc. (“Reunion”), its Principal Owner, Designated Broker and President, David Thayer, (“Thayer”), and its Owner and Vice President, R. Kent Harvey (collectively, “Defendants”), alleging upon information and belief as follows:

INTRODUCTION

1. This is a civil fraud action by the United States against Reunion to recover treble

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1 damages and civil penalties under the False Claims Act (“FCA”), as amended, 31 U.S.C. §§ 3729 *et*
2 *seq.*, and common-law damages arising from fraud on the United States Department of Housing and
3 Urban Development (“HUD”) in connection with Reunion’s residential mortgage lending business.

4 2. As one of its functions, HUD, through its Federal Housing Administration (“FHA”),
5 insures lenders against losses on mortgage loans to home buyers pursuant to the provisions of the
6 National Housing Act. 12 U.S.C. §§ 1701-1701z-17 (2006). Under HUD-FHA’s mortgage insurance
7 program, if a homeowner fails to make payments on the mortgage loan and the mortgage holder
8 forecloses on the property, HUD-FHA will pay the mortgage holder the balance of the loan (together
9 with interest due and other costs) and assume ownership and possession of the property.

10
11 3. As set forth more fully below, from 2007 to 2012, Reunion participated in FHA’s Direct
12 Endorsement Lender Program (“DEL”).

13
14 4. At the time of Reunion’s withdrawal from the DEL Program, on May 10, 2012, HUD-
15 FHA had received insurance claims for 116 defaulted loans certified by Reunion totaling over \$21
16 million. This action focuses on twelve of those loans for which claims were filed by Reunion and paid
17 by HUD-FHA.

18 5. Under FHA’s DEL Program, HUD-FHA insured twelve (12) materially deficient loans
19 that Reunion employees individually certified to HUD-FHA met the requirements for proper
20 underwriting, when they had not and were ineligible for FHA insurance. The twelve loans will be
21 referred to herein as the “Covered Transactions.”

22 6. As a result of Reunion’s annual certifications of compliance and false individual loan
23 certifications of eligibility that induced HUD-FHA to insure the Covered Transactions, between 2009
24 and January 2011, HUD-FHA paid \$1,630,527.89 in insurance claims on the defaulted Covered
25 Transactions.

26 7. This is also an action against Reunion, Thayer and Harvey, on the grounds that between
27 December 2011 and April 2012, Reunion transferred to Thayer and Harvey \$1,775,783.50, in violation
28 of the Federal Debt Collection Procedure Act, 28 U.S.C. § 3304.

JURISDICTION AND VENUE

8. This Court has jurisdiction over the subject matter of this action pursuant to 31 U.S.C. § 3730(a), and 28 U.S.C. §§ 1331, 1345.

9. Defendant Reunion is a California corporation with its principle place of business in this District and is subject to the jurisdiction of this Court.

10. Defendant David Thayer resides in this District.

11. Defendant R. Kent Harvey resides in this District.

12. Venue is proper in this District pursuant to 31 U.S.C. § 3732(a) and 28 U.S.C. § 1391(b).

THE PARTIES

13. At all times material to this civil action, HUD-FHA was an agency and instrumentality of Plaintiff United States and its activities, operations, and contracts were paid from Federal funds.

14. Defendant Reunion, a mortgage lender, is a California corporation with its principal place of business in Milpitas, California.

15. Defendant David Thayer was at all relevant times the President, Director, and principal co-owner of Reunion and resides in Pleasanton, California.

16. Defendant R. Kent Harvey was at all relevant times the Senior Vice President and co-owner of Reunion and resides in Los Altos, California.

17. Further, at all times relevant, and in order to participate in the DEL Program, Defendant Reunion identified Thayer as its designated principal officer/broker with the responsibility for supervision and control of its employees and Thayer acknowledged and accepted this responsibility.

THE FALSE CLAIMS ACT

18. The FCA provides liability for any person (i) who “knowingly presents or causes to be presented, a false or fraudulent claim for payment or approval”; or (ii) who “knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim.” 31 U.S.C. § 3729(a)(1)(A)-(B). The FCA further provides that any person who violates the Act: “is liable to the United States Government for a civil penalty of not less than [\$5,500] and not more than [\$11,000] . . . , plus 3 times the amount of damages which the Government sustains because of the act of that person.”

31 U.S.C. § 3729(a); *see* 28 C.F.R. § 85.3(a)(9).

19. Under California law, the solicitation of residential mortgages is regulated by the California Department of Real Estate (“CA DRE”). Only CA DRE licensed brokers or CA DRE licensed agents acting under the supervision of a broker may engage in the business of residential mortgage loan solicitation.

20. Under California law, a corporation may hold a real estate broker’s license and at all times relevant to this complaint, Reunion Mortgage, Inc., was licensed with the CA DRE as a real estate broker.

21. Under California law, a corporate broker must designate an officer as the broker for the corporation. A California corporate real estate broker operates only through and because of the license of its designated officer.

22. Under California law, the corporation’s designated officer/broker “shall be responsible for the supervision and control of the activities conducted on behalf of the corporation by its officers and employees necessary to secure full compliance with the provisions of this division.” Cal. Bus. & Prof. Code § 10159.2(a).

FACTUAL BACKGROUND

A. FHA Direct Endorsement Lender Program Overview

23. HUD-FHA mortgage insurance programs help low- and moderate-income families become homeowners by lowering down payment requirements, some closing costs, and qualifying criteria. By protecting lenders against default on mortgages, HUD-FHA mortgage insurance encourages lenders to make loans to otherwise creditworthy borrowers that might not qualify under conventional underwriting requirements.

24. To assist as many qualified homeowners as possible, and to provide maximum economic opportunities to lenders interested in obtaining HUD-FHA insurance on mortgages loans they make, FHA operates the DEL program. The DEL program grants participating lenders in the private sector the authority to endorse mortgages that are qualified for HUD-FHA insurance. In reviewing mortgages for

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1 eligibility for HUD-FHA insurance, DELs are entrusted with safeguarding the public from taking on
2 risks that exceed statutory, regulatory and programmatic limits. DELs act as fiduciaries of HUD-FHA
3 in underwriting mortgages and endorsing them for HUD-FHA insurance.

4 25. Once qualified as a DEL, the DEL is responsible for all aspects of the mortgage
5 application, the property analysis, and the underwriting of the mortgage.

6 26. To obtain and maintain DEL status, a corporate officer and principal owner with
7 authority legally bind the mortgagee must submit an annual certification to HUD-FHA as follows:

8 I know or am in the position to know, whether the operations of the above-named
9 mortgagee conform to HUD-FHA regulations, handbooks, and policies. I certify
10 that to the best of my knowledge, the above-named mortgagee conforms to all
11 HUD-FHA regulations necessary to maintain its HUD-FHA approval, and that the
above-named mortgagee is fully responsible for all actions of its employees
including those of its HUD-FHA approved branch offices.

12 27. The annual certification requires compliance with the basic eligibility requirements for
13 DELs, which includes compliance with the mandatory HUD-FHA rules concerning due diligence in
14 underwriting and the implementation of a mandatory quality control plan. The annual certification
15 requires mortgagees to certify to the accuracy of each of the statements found in the certification.
16 Certification of these statements is required to ensure that mortgagees provide FHA with the most
17 current information about their institution and its compliance with all applicable laws for the fiscal year
18 in which the mortgagee is renewing its FHA approval status. Consequently, a mortgagee's principal
19 owner or corporate officer's online annual certification covers the period for the fiscal year the
20 mortgagee is recertifying. If a mortgagee's principal owner or corporate officer is not sure whether one
21 or more of the statements comprising the online annual certification is accurate for their institution, then
22 the "Unable to Certify" box must be checked. *See* Mortgagee Letter 2009-25.

23 28. To qualify for HUD-FHA mortgage insurance, a mortgage must meet all of the applicable
24 HUD-FHA requirements. Those requirements relate to, among other things, the adequacy of the
25 borrower's income to meet the mortgage payments in addition to other financial obligations, the
26 borrower's creditworthiness, and the borrower's available cash to close the transaction and that amount
27 in light of the borrower's savings history.

28 29. On a mortgage-by-mortgage basis, HUD-FHA requires DELs to conduct due diligence to
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1 ensure that each mortgage is eligible for HUD-FHA insurance as set forth in HUD-FHA rules. These
2 rules exist to prevent HUD-FHA from insuring mortgages that exceed the risk levels set by statute and
3 regulations. A DEL must assure HUD-FHA that every endorsed mortgage meets all HUD-FHA rules.
4 HUD-FHA requires the DEL to certify, for each mortgage the lender endorses, that the lender has
5 conducted due diligence in accordance with all HUD-FHA rules and to the integrity of the data and
6 documentation used to endorse the loan.

7 30. The DEL Program generally works as follows: The DEL originates a proposed loan or, in
8 some instances, acts as a sponsoring lender by underwriting and funding proposed mortgages originated
9 by other FHA-approved lenders known as correspondents or third-party originators. In either case, the
10 DEL ultimately reviews and is responsible for the proposed mortgage. The borrower, along with the
11 DEL's representative, completes the loan application. A loan officer collects all supporting
12 documentation from the borrower and submits the application and documentation to the DEL. A
13 professional underwriter employed by the DEL performs a mortgage credit analysis to determine the
14 borrower's ability and willingness to repay the mortgage debt. The DEL's underwriter makes the
15 underwriting decision as to whether the mortgage may be approved for HUD-FHA insurance or not,
16 according to HUD-FHA rules. This process is referred to as "manual underwriting." As described
17 further below, the DEL may also use an FHA-approved automated underwriting system ("AUS") to
18 analyze the borrower's creditworthiness. If the DEL has decided that the mortgage may be approved for
19 HUD-FHA insurance in accordance with HUD-FHA rules, the DEL funds the loan. Thereafter, the DEL
20 certifies that the mortgage qualifies for HUD-FHA insurance. FHA endorses the loan on the basis of the
21 DEL's certification and provides the DEL with a mortgage insurance certificate.

22 31. Regardless of whether the loan is manually underwritten or underwritten with the
23 assistance of an AUS, the DEL is responsible for all aspects of the mortgage application, the property
24 analysis, and the underwriting of the mortgage. HUD-FHA endorses mortgages in reliance upon the
25 DEL's certifications that the mortgages are eligible for HUD-FHA insurance. Significantly, DELs
26 obligate HUD-FHA without prior independent HUD-FHA review.

27 32. HUD-FHA grants DEL authority to the lender, not any individual underwriters.
28 However, to qualify for HUD-FHA approval as a DEL, a lender must have a qualified underwriter on

1 staff. The underwriter's responsibilities are critical elements of the DEL Program, and each DEL must
2 certify that its underwriters meet HUD-FHA qualifications.

3 33. An underwriter must be a full-time employee of the mortgage lender and must either be a
4 corporate officer with signatory authority or otherwise be authorized to bind the mortgage lender in
5 matters involving origination of mortgage loans. HUD Handbook 4060.1 REV-2. An underwriter must
6 also be a reliable and responsible professional who is skilled in mortgage evaluation and able to
7 demonstrate knowledge and experience regarding principles of mortgage underwriting.

8 34. "All employees who will sign applications for mortgage insurance on behalf of the
9 mortgagee or report loans for insurance shall be corporate officer or shall otherwise be authorized to
10 bind the lender or mortgagee in the origination transaction." 24 C.F.R. § 202.5(c).

11 35. HUD-FHA's DEL Code of Ethics requires the lender to conduct its business operations
12 in accordance with accepted sound mortgage lending practices, ethics, standards, and all federal and
13 state laws applicable to mortgage banking. See HUD Handbook 4155.2.

14 36. An underwriter must "evaluate [each] mortgagor's credit characteristics, adequacy and
15 stability of income to meet the periodic payments under the mortgage and all other obligations, and the
16 adequacy of the mortgagor's available assets to close the transaction, and render an underwriting
17 decision in accordance with applicable regulations, policies and procedures." 24 C.F.R. § 203.5(d).

18 37. HUD-FHA relies on DELs to conduct due diligence on loans originated under the DEL
19 Program. The purposes of due diligence include determining a borrower's ability and willingness to
20 repay a mortgage debt, thus limiting the risk of default and collection difficulties. *See id.* Due diligence
21 thus requires an evaluation of, among other things, a borrower's credit history, capacity to pay, and cash
22 to close.

23 38. In all cases, a DEL owes HUD-FHA the duty, as prescribed by federal regulation, to
24 "exercise the same level of care which it would exercise in obtaining and verifying information for a
25 loan in which the mortgagee would be entirely dependent on the property as security to protect its
26 investment." 24 C.F.R. § 203.5(c)).

27 39. HUD-FHA has set specific rules for due diligence predicated on sound underwriting
28 principles. In particular, HUD-FHA requires DELs to be familiar with, and to comply with, governing

1 HUD-FHA Handbooks and Mortgagee Letters, which provide detailed processing instructions to DELs.
2 These materials specify the minimum due diligence requirements with which DELs must comply.

3 40. With respect to ensuring that borrowers have sufficient credit, a DEL must comply with
4 governing HUD-FHA Handbooks, such as HUD 4155.1, and evaluate whether a borrower has the ability
5 and willingness to repay the mortgage debt. HUD-FHA has informed DELs that past credit performance
6 serves as an essential guide in determining a borrower's attitude toward credit obligations and in
7 predicting a borrower's future actions.

8 41. To properly evaluate a borrower's creditworthiness, a DEL must, at a minimum, obtain
9 and review credit histories; analyze debt obligations; reject documentation transmitted by unknown or
10 interested parties; inspect documents for proof of authenticity; obtain adequate explanations for
11 collections, judgments, recent debts and recent credit inquiries; establish income stability and make
12 income projections; obtain explanations for any gaps in employment; document any gift funds; calculate
13 debt ratios and compare those ratios to the fixed ratios set by HUD-FHA rules; and consider and
14 document any compensating factors permitting deviations from those ratios.

15 42. In order to help lenders more efficiently determine borrowers' creditworthiness, HUD-
16 FHA allows DELs to use an FHA-approved AUS to review loan applications. The AUS interfaces with
17 FHA's TOTAL Mortgage Scorecard ("TOTAL"). The AUS algorithmically analyzes the various data
18 points and variables of the transaction and returns a credit recommendation of "accept"/"approve" or a
19 "refer"/"caution."

20 43. Because the AUS recommendation is entirely driven by the totality of the variables input
21 by the DEL, no one variable alone will determine the outcome. Rather, the system looks to the interplay
22 of the variables with each other in making its recommendation. Accordingly, the integrity of the value
23 of each variable is absolutely necessary for the AUS to provide a meaningful recommendation. In other
24 words, if the DEL inputs untruthful borrower information, such as inflated or unsubstantiated income,
25 the AUS will be unable to accurately analyze the application, resulting in a false positive. Or, if the
26 DEL falsely identifies atypical strengths in an application, such as a high amount of reserves funds that
27 are not properly documented or nonexistent, the AUS will over-rely on these and under-rely on
28 traditional metrics like various debt-to-income ratios which would also result in a false positive.

1 44. If the loan is rated “accept”/“approve,” the DEL will be required to adhere to
2 documentation standards that must be followed in order for the loan to be eligible for HUD-FHA
3 insurance. The DEL must collect and inspect these documents and, using sound underwriting principles,
4 verify the integrity of these documents. If a document does not comport with underwriting best
5 practices or even HUD-FHA’s minimum standards for integrity the DEL should discount it from the
6 underwriting process.

7 45. Further, if a document does not support a variable from the borrower’s application, the
8 variable must be removed from the underwriting process. For example, if a document does not
9 adequately support the borrower’s claimed commission income, that commission income must be
10 removed from the application.

11 46. In cases where a DEL uses an FHA-approved AUS, and the system rates a loan as an
12 “accept” or “approve,” the DEL must make the following certification on the form HUD-92900-A, in
13 sum and substance:

14 This mortgage was rated as an “accept” or “approve” by a FHA-approved
15 automated underwriting system. As such, the undersigned representative of the
16 mortgagee certifies to the integrity of the data supplied by the lender used to
17 determine the quality of the loan, that Direct Endorsement Underwriter reviewed
18 the appraisal (if applicable) and further certifies that this mortgage is eligible for
19 HUD mortgage insurance under the Direct Endorsement program. I hereby make
20 all certifications required by this mortgage as set forth in HUD Handbook 4000.4.

21 47. If the loan is rated “refer”/“caution,” the loan must be manually underwritten by the DEL
22 underwriter based on all current HUD-FHA guidelines and best practices of the mortgage underwriting
23 industry.

24 48. In cases where a DEL underwriter manually underwrites the loan, the underwriter must
25 make the following certification on the form HUD-92900-A, in sum and substance:

26 This mortgage was rated as a “refer” or “caution” by a FHA-approved automated
27 underwriting system, and/or was manually underwritten by a Direct Endorsement
28 underwriter. As such, the undersigned Direct Endorsement Underwriter certifies
that I have personally reviewed the appraisal report (if applicable), credit
application, and all associated documents and have used due diligence in
underwriting this mortgage. I find that this mortgage is eligible for HUD
mortgage insurance under the Direct Endorsement program and I hereby make all
certifications required for this mortgage as set forth in HUD Handbook 4000.4.

49. The certifications in HUD Handbook 4000.4, incorporated by reference in the certifications above, include the certification that the mortgage complies with HUD-FHA underwriting requirements contained in all applicable HUD-FHA Handbooks and Mortgagee Letters.

50. Absent a truthful loan application certification, a DEL is not entitled to approve a particular loan for HUD-FHA insurance. Once a DEL, HUD relies on each individual loan certification to endorse the loan and provide the lender with an FHA mortgage insurance certificate. Once a loan is endorsed for insurance, the loan receives a unique FHA case number.

B. Reunion's Underwriting and False Loan Certifications on the Covered Transactions.

51. From September 12, 2007, until May 10, 2012, Thayer applied for and received Reunion's approval for participation in the HUD-FHA DEL Program as described above. In order to continue to participate in the DEL Program, Thayer, as Reunion's President, Principal Owner and Designated Broker, provided the requisite documentation and certified annually that Reunion was complying with HUD-FHA guidelines.

52. Specifically, each year between 2007 and 2011, Thayer provided annual certifications to HUD-FHA stating:

I know or am in the position to know, whether the operations of the above-named mortgagee conform to HUD-FHA regulations, handbooks, and policies. I certify that to the best of my knowledge, the above-named mortgagee conforms to all HUD-FHA regulations necessary to maintain its HUD-FHA approval, and that the above-named mortgagee is fully responsible for all actions of its employees including those of its HUD-FHA approved branch offices.

53. While unconditionally approved for participation in the DEL Program, Reunion employees endorsed the following Covered Transactions for HUD-FHA insurance: FHA Case Nos. 043-7533603, 042-8491871, 093-6480604, 042-08144426, 151-8357405, 043-7844332, 483-3929987, 421-4430394, 413-4874470, 411-4007716, 043-7511071, and 048-5356153.

54. Each Covered Transaction at issue was either underwritten using an FHA-approved AUS program or manually underwritten by a Direct Endorsement underwriter employed by Reunion.

55. In the case of the Covered Transactions underwritten using an AUS, a Reunion

1 representative certified on HUD-92900-A to the integrity of the data supplied by Reunion to determine
2 the quality of the loan and further certified that the mortgage is eligible for HUD-FHA mortgage
3 insurance under the DEL program.

4 56. In the case of the manually underwritten Covered Transaction (FHA Case No. 483-
5 3929987), Reunion's DEL underwriter certified on HUD-92900-A to having personally reviewed the
6 credit application and all associated documents and has used due diligence in underwriting the
7 mortgage. The underwriter further certified to finding that the mortgage is eligible for HUD-FHA
8 mortgage insurance under the DEL program.

9 57. The United States alleges that the aforementioned individual loan certifications on HUD-
10 92900-A are false because of Reunion's failures to even meet HUD-FHA's minimum underwriting
11 standards and, as a result, the Government has incurred losses in connection with the Covered
12 Transactions.

13 58. All of the Covered Transactions at issue in this matter were insured through the HUD-
14 FHA DEL program, which Reunion could not participate in absent Thayer's annual certifications.

15 59. For each loan, Reunion knowingly provided false statements to HUD-FHA when they
16 either certified "to the integrity of the data supplied by the lender used to determine the quality of the
17 loan" or when Reunion's DEL underwriter certified to having "personally reviewed the appraisal report
18 (if applicable), credit application, and all associated documents and hav[ing] used due diligence in
19 underwriting the mortgage" and that the mortgage "is eligible for HUD mortgage insurance under the"
20 DEL program.

21 60. Each of the Covered Transactions went into default. Insurance claims were presented to
22 HUD-FHA, and HUD-FHA, in honor of its mortgage insurance commitments, paid the mortgage
23 insurance claims.

24 61. Both Reunion's individualized loan certifications and Thayer's annual certification were
25 necessary for Reunion to retain DEL status and remain eligible for HUD-FHA funding.

26 **(FHA Case No. 042-8144426)**

27 62. On November 28, 2008, Reunion approved this loan, thereby binding HUD-FHA to
28 insure it; however, the data Reunion supplied to the AUS lacked the necessary integrity.

63. Reunion represented the borrower's qualifying income as \$8,076; however, the borrower's verified monthly income was \$6,434.

64. Reunion performed inadequate due diligence and improperly relied solely on the \$8,076 monthly income reported on the borrower's mortgage application even though Reunion's verbal Verification of Employment ("VOE") confirmed the borrower earned \$6,034. Further, the borrower's 2007 tax return showed annual wages of \$70,132 or \$5,844 per month.

65. Reunion represented the borrower's payment-to-income ratio, also called the "front-end" ratio as 26.85%, but the true ratio was 34%.

66. Reunion represented the borrower's total debt-to-income ratio, also called the "back-end" ratio as 43.64%, but the true ratio was 55%.

67. Had Reunion followed HUD-FHA policies, the borrower would not have qualified for the loan.

68. These false statements were material to the AUS system's acceptance of this application and the issuance of mortgage insurance by HUD-FHA.

69. After the borrower defaulted on the loan, HUD-FHA received a mortgage insurance claim in July 2010, and paid \$78,477.89 pursuant to HUD-FHA's insurance obligations.

(FHA Case No. 042-8491871)

70. On August 11, 2009, Reunion approved this loan, thereby binding HUD-FHA to insure it; however, the data Reunion supplied to the AUS lacked the necessary integrity.

71. Reunion improperly accepted the co-borrower's unsupported self-employment income of \$1,212 in violation of HUD-FHA guidelines. Reunion performed inadequate due diligence and improperly relied solely on the mortgage application which stated the co-borrowers line of employment was "golf caddy" for seven years; however, the borrowers' 2007 tax forms stated the co-borrower's self-employment was doing "odd jobs" and the 2008 tax forms stated self-employment was as a "part time Sherpa." In order to accept self-employment income, HUD-FHA requires, at a minimum, two years of successful self-employment in the same line of work. The driving factor the underwriter is required to look for is the stability of this income in the past to justify its continuance for the foreseeable future. Accordingly, the co-borrower's self-employment income must be removed from the application.

73. Reunion' use of an improperly inflated income when calculating the qualifying ratios resulted in favorable ratios for the borrowers which falsely passed HUD-FHA's acceptable back-end ratios.

75. Had Reunion followed HUD-FHA policies, borrower would not have qualified for the loan.

77. After the borrowers defaulted on the loan, HUD-FHA received a mortgage insurance claim in January 2011, and paid \$72,644.52 pursuant to HUD-FHA's insurance obligations.

78. On June 13, 2008, Reunion approved this loan, thereby binding HUD-FHA to insure it; however, the data Reunion supplied to the AUS lacked the necessary integrity.

80. Reunion represented the front-end ratio as 36.3% but, the true ratio was 39.24%.

82. To counter-balance the effect of these excessively high ratios, Reunion presented as compensating factors that the borrower was a minimal user of credit. However Reunion had in their possession a credit report that showed that borrower had six or more outstanding loans with a combined balance of \$164,098.

83. Further, Reunion ignored the negative indicator that the proposed housing expense of \$2,047 was nearly twice the current housing expense of \$1,150.

(FHA Case No. 048-5356153)

105. On August 31, 2009, Reunion approved this loan, thereby binding HUD-FHA to insure it; however, the data Reunion supplied to the AUS lacked the necessary integrity.

106. Reunion omitted a debt of \$4,889, representing only \$352 in monthly payment obligations, from the underwriting analysis. In fact, the AUS findings required evidence of this debt's payoff prior to funding. However, because it was marked for payoff prior to funding it was not included in the underwriting analysis and thus, the underwriter represented this borrower's debt as lower than it actually was.

107. Reunion represented the back-end ratio as 55.15%, but the true ratio was 61.81%.

108. Had Reunion followed HUD-FHA policies, the borrower would not have qualified for the loan.

109. These false statements were material to the AUS system's acceptance of this application and the issuance of mortgage insurance by HUD-FHA.

110. After the borrower defaulted on the loan, HUD-FHA received a mortgage insurance claim in January 2011, and paid \$44,776.08 pursuant to HUD's insurance obligations.

(FHA Case No. 093-6480604)

111. On October 29, 2008, Reunion approved this loan, thereby binding HUD-FHA to insure it; however, the data Reunion supplied to the AUS lacked the necessary integrity.

112. The borrower's income and employment were not properly verified by the underwriter as required by HUD-FHA underwriting guidelines. HUD-FHA's underwriting guidelines require a borrower's most recent year-to-date pay stub documenting one full month's earnings; however, Reunion documented only one pay stub showing less than one full month. Further, the pay stub identified the income as commission and not base pay. If commission income is used to qualify it must be documented for two years and be reasonably expected to continue. Further, the VOE did not clearly identify the borrower's income but commented "per pay stub," which showed \$2,486 which was considerably lower than the \$3,203 on the mortgage application.

113. In 2006, the borrower's income was 100% commission from the real estate business. In 2007, the borrower continued with his real estate business but experienced a dramatic decline in sales.

1 In 2007, the borrower began working in the trucking business and, based on the pay stub provided,
2 100% of his income from this business was commission. For 2008, the borrower provided no income
3 documentation from his real estate business.

4 114. HUD-FHA guidelines state “[c]ommission income showing a decrease from one year to
5 the next requires significant compensating factors before a borrower can be approved for the loan.” The
6 borrower’s real estate income decreased by 73% from 2006 to 2007 and was non-existent in 2008,
7 rendering any real estate related income unusable.

8 115. Depending on when in 2007 the borrower transitioned from real estate to trucking, his
9 2008 commission when he applied for the mortgage was for either less than one year or greater than one
10 year but less than two years.

11 116. If the borrower had been in the trucking business for less than one year, then, according
12 to HUD guidelines, his income from that business could not be considered in approving the loan.

13 117. If the borrower had been in the trucking business for more than one year but less than two
14 years his income from that business could only be used if the “underwriter can: a) document the
15 likelihood that the income will continue, and b) soundly rationalize accepting the commission income.”
16 However, the underwriter made no such documentation or rationalization. Undermining the ability to
17 use his trucking income is the fact that within the last two years he had completely changed business
18 from real estate to trucking.

19 118. Setting aside the fact that the borrower’s commission income was not documented or
20 even usable, accepting the amount on the pay stub provided (\$2,486) rather than what the borrower
21 provided on the mortgage application would result in a back-end ratio of 63%, which is considerably
22 higher than the 56% Reunion represented as true.

23 119. Even assuming the borrower’s income could be used at all, Reunion failed to properly
24 calculate his income. HUD-FHA guidelines require that for borrowers making 25% or more of their
25 income from commissions, unreimbursed business expenses must be deducted from their income. Here,
26 the borrower’s income was at all times 100% commission. The 2007 tax return Schedule C showed
27 \$19,350 of unreimbursed business expenses leaving a net income for the year of \$7,550. The
28 borrower’s 2006 Schedule C showed \$42,704 of unreimbursed business expenses showing a net income

1 of \$27,968. Further, no due diligence was done to understand and account for the borrower's trucking-
2 related business expenses. Had these business expenses been deducted from the borrower's income the
3 front-end and back-end ratios would have been significantly higher still.

4 120. Further, Reunion failed to properly verify the borrower's current employment. The VOE
5 in the file indicates a start date of 09/17/08; which is clearly false considering the pay stub provided by
6 the borrower was dated 08/07/08. Reunion failed to resolve this discrepancy.

7 121. Reunion ignored the borrowers' poor credit history. In 2003, the co-borrower had her
8 chapter 7 bankruptcy discharged. While HUD-FHA only requires, at a minimum, two years to have
9 passed since the bankruptcy, HUD-FHA also requires the borrower to reestablish good credit or choose
10 to not incur new obligations. However, the borrowers amassed 12 new loans in those five years totaling
11 over \$78,000 in new debt. This shows Reunion's poor due diligence in assessing the borrowers'
12 willingness to repay this loan.

13 122. Had Reunion followed HUD-FHA policies, the borrowers would not have qualified for
14 the loan.

15 123. These false statements were material to the AUS system's acceptance of this application
16 and the issuance of mortgage insurance by HUD-FHA.

17 124. After the borrowers defaulted on the loan, HUD-FHA received a mortgage insurance
18 claim in October 2010, and paid \$246,240.51 pursuant to HUD-FHA's insurance obligations.

19 **(FHA Case No. 151-8357405)**

20 125. On May 27, 2008, Reunion approved this loan, thereby binding HUD-FHA to insure it;
21 however, the data Reunion supplied to the AUS lacked the necessary integrity.

22 126. The borrower's mortgage application was dated May 6, 2008.

23 127. To verify income and employment, HUD-FHA requires the most recent full month's pay
24 stub showing, among other things, current and year-to-date earnings. According to HUD-FHA
25 guidelines, "most recent" means the most recent available at the time of application. In this case, the
26 most recent full month's pay stubs would have included pay through April 30, 2008. However, Reunion
27 only collected pay stubs through March 27, 2008. Had Reunion collected the most recent pay stubs,
28 through the end of April, 2008, it would have been clear that the borrower was currently on leave and

1 not earning overtime income.

2 128. Reunion were in possession of a note from the borrower's doctor dated March 27, 2008,
3 prescribing leave from work to relieve stress, anxiety, and panic attacks.

4 129. This combination of the lack of April pay stubs and the March doctor's note is evidence
5 that the borrower was experiencing a significant change in income and the stability of future overtime
6 income was seriously in question.

7 130. The AUS findings required that if overtime income was used to qualify the borrower, it
8 needed to be verified for two years and have a reasonable expectation of continuing. However, there
9 was no reasonable expectation the borrower's overtime would continue.

10 131. Reunion represented the front-end ratio as 29.63%, but the true ratio was 43.8%.

11 132. Reunion represented the back-end ratio as 29.87%, but the true ratio was 44.2%.

12 133. Had Reunion followed HUD-FHA policies, the borrower would not have qualified for the
13 loan. In fact, the stated reason for swift delinquency was the borrower's unemployment due to the
14 medical leave that was documented at the time of the borrower's application.

15 134. These false statements were material to the AUS system's acceptance of this application
16 and the issuance of mortgage insurance by HUD-FHA.

17 135. After the borrower defaulted on the loan, HUD-FHA received mortgage insurance claims
18 in October and December 2009, and paid \$189,408.73 pursuant to HUD-FHA's insurance obligations.

19 **(FHA Case No. 411-4007716)**

20 136. On January 11, 2008, Reunion approved this loan, thereby binding HUD-FHA to insure
21 it; however, the data Reunion supplied to the AUS lacked the necessary integrity.

22 137. The borrowers did not have sufficient funds to close the loan as required by HUD-FHA.
23 The loan required a cash investment of \$2,153; however, the borrowers' bank records showed a balance
24 at the time of the loan of only \$987. Reunion failed to account for the shortfall or provide any
25 documentation showing the source of the required funds.

26 138. Reunion omitted over \$32,000 in liabilities, representing \$855 of monthly obligations,
27 from the underwriting analysis during liability reconciliation without documentation that supported the
28 omission.

1 retiree receiving the benefits in order to explain including the retirement income in the co-borrower's
2 total income.

3 148. Reunion calculated the primary borrower's monthly income by improperly including
4 unsupported overtime pay. Despite an AUS requirement that overtime could only be included if verified
5 for the past two years with the same employer, Reunion included unsupported overtime which inflated
6 the primary borrower's monthly income by \$848.

7 149. Reunion represented the front-end ratio as 26%, but the true ratio was 40%.

8 150. Reunion represented the back-end ratio as 47% but the true ratio was 72%.

9 151. Had Reunion followed HUD-FHA policies, the borrowers would not have qualified for
10 the loan.

11 152. These false statements were material to the AUS system's acceptance of this application
12 and the issuance of mortgage insurance by HUD-FHA.

13 153. After the borrowers defaulted on the loan, HUD-FHA received mortgage insurance
14 claims in May 2010 and July 2010, and paid \$154,969.81 pursuant to HUD-FHA's insurance
15 obligations.

16
17 **(FHA Case No. 421-4430394)**

18 154. On August 28, 2008, Reunion approved this loan, thereby binding HUD-FHA to insure it;
19 however, the data Reunion supplied to the AUS lacked the necessary integrity.

20 155. The borrowers applied for this loan on July 25, 2008. However, on June 18, 2008, the
21 co-borrower terminated her employment with Connor's Drilling. AUS findings require the most recent
22 year-to-date pay stub, which would have been through June 30, 2008; however, Reunion only
23 considered pay stubs through the end of April, 2008, which were nearly three-months old at the time of
24 the application. Had Reunion followed these guidelines and obtained pay stubs through the end of June,
25 2008, it would have known that the co-borrower's employment had been terminated.

26 156. Further, Reunion's VOE contradicted the mortgage application. The VOE stated that the
27 co-borrower worked for Schlumberger; however, the mortgage application stated she worked for
28 Connor's Drilling.

158. Reunion represented the front-end ratio as 23.19%, but the true ratio was 51.63%.

160. Had Reunion followed HUD-FHA policies, the borrowers would not have qualified for the loan.

162. After the borrowers defaulted on the loan, HUD-FHA received mortgage insurance claims in April and June 18, 2010, and paid \$143,629.28 pursuant to HUD-FHA's insurance obligations.

163. On August 8, 2008, Reunion approved this loan, thereby binding HUD-FHA to insure it.

165. Nevertheless, Reunion's Direct Endorsement underwriter approved this loan for HUD-FHA insurance.

167. Reunion falsely identified the borrower's position as "shop supervisor;" however, the VOE from the employer identified the borrower's position as that of "shop tech."

1 169. To include overtime, AUS findings require two years' documentation supporting the
2 overtime and a reasonable expectation it will continue; however, Reunion obtained no documentation
3 beyond the three incomplete pay stubs.

4 170. Reunion represented the front-end ratio as 22.2%, but the true ratio was 35.96%— more
5 than 4% higher than the maximum allowed for manually underwritten loans.

6 171. Reunion represented the back-end ratio as 43%, but the true ratio was 54%—11% higher
7 than the maximum ratio allowed for manually underwritten loans.

8 172. Had Reunion followed HUD-FHA policies, the borrower would not have qualified for the
9 loan.

10 173. These false statements were material to the issuance of mortgage insurance by HUD-
11 FHA.

12 174. After the borrower defaulted on the loan, HUD-FHA received mortgage insurance claims
13 in July and September 2009, and paid \$137,731.20 pursuant to HUD-FHA's insurance obligations.

14 **C. The Payment of the Dividend**

15 175. Defendant Thayer, as Principal Owner, owns 50.75% of Reunion and Defendant Harvey
16 owns 49.25% of Reunion.

17 176. At all relevant periods, Thayer was the Chair of the Board of Directors for Reunion and
18 Harvey was a Board Member.

19 177. In 2010, Reunion reported on their tax returns \$65,671,496 in assets

20 178. In 2011, Reunion reported on their tax returns \$38,576,335 in assets

21 179. In 2012, Reunion initially reported on sworn financial statements \$15,324,826 in assets in
22 the first quarter, but in July 2012, reported \$202,968 and in August 2012, reported \$90,381.

23 180. On December 21, 2011, December 28, 2011, March 23, 2012, April 19, 2012, and April
24 30, 2012, Reunion made dividend payments to Defendant Thayer totaling \$901,210.13.

25 181. On December 21, 2011, December 28, 2011, March 23, 2012, April 19, 2012, and April
26 30, 2012 Reunion made dividend payments to Defendant Harvey totaling \$874,573.37.

27 182. On April 24, 2012, Harvey and Thayer met alone as Reunion's Board of Directors and
28 approved "a dividend distribution sufficient enough to liquidate the corporation."

FIRST CAUSE OF ACTION**False Claims Act, 31 U.S.C. § 3729(a)(1) (2006) and, as amended, 31 U.S.C. § 3729(a)(1)(A)
Presenting or Causing False Claims to Be Presented (Reckless Underwriting)**

183. The Government incorporates by reference paragraphs 1 through 174 as if set forth fully herein.

184. By virtue of the acts described above and in violation of 31 U.S.C. § 3729(a)(1) (2006) , and, as amended, 31 U.S.C. § 3729(a)(1)(A), Defendants Reunion and Thayer engaged in reckless underwriting of the Covered Transactions.

185. As set forth above, Reunion, knowingly, or acting with deliberate ignorance and/or reckless disregard for the truth, caused false or fraudulent claims for FHA insurance to be presented to an officer or employee of the United States Government by, *inter alia*, annually representing and certifying to HUD-FHA as a DEL all of Reunion's loans were eligible for FHA insurance when they were not. Reunion knowingly, or acting with deliberate ignorance and/or reckless disregard for the truth, caused false or fraudulent claims for FHA insurance to be presented to an officer or employee of the United States Government. Reunion did so by, *inter alia*, acting as a DEL and submitting false loan level certifications for FHA loans to HUD-FHA in order to get FHA to endorse these mortgages that did not meet HUD requirements and contained unacceptable risk for FHA insurance.

186. Reunion knowingly, or acting with deliberate ignorance and or/reckless disregard for the truth, presented to an officer or employee of the Government false or fraudulent claims for payment when it submitted claims for HUD-FHA insurance for the defaulted Covered Transactions that Reunion as a DEL falsely certified were eligible for HUD-FHA insurance.

187. A truthful individual loan certification for HUD-FHA endorsement is a condition of payment of FHA insurance on that loan. HUD-FHA paid insurance claims, and incurred losses, on the Covered Transaction that were falsely certified as eligible for HUD-FHA insurance.

188. By reason of the foregoing, the Government has been damaged in a substantial amount to be determined at trial, and is entitled to treble damages and a civil penalty as required by law for each transaction.

SECOND CAUSE OF ACTION

False Claims Act, 31 U.S.C. § 3729(a)(2) (2006), and, as amended, § 3729(a)(1)(B)

Use of False Statements in Support of False Claims (Reckless Underwriting)

189. The Government incorporates by reference paragraphs 1 through 174 as if set forth fully herein.

190. By virtue of the acts described above and in violation of 31 U.S.C. § 3729(a)(2) (2006), and, as amended, § 3729(a)(1)(B), Reunion knowingly, or acting with deliberate ignorance and or/reckless disregard for the truth, made, used, or caused to be made or used, false records and/or statements material to false or fraudulent claims with respect to the Covered Transactions that Reunion falsely certified were eligible for HUD-FHA insurance. Specifically, senior management knowingly submitted false annual certifications to HUD-FHA and Reunion knowingly submitted false individual loan certifications to HUD-FHA, representing, *inter alia*, that each loan was eligible for HUD-FHA mortgage insurance under the DEL program.

191. Through these annual certifications, Reunion was an approved DEL. Reunion in turn submitted false individual loan certifications to induce HUD-FHA to endorse Covered Transactions for insurance and to get HUD-FHA to pay false insurance claims when the Covered transactions defaulted.

192. A truthful individual loan certification for HUD-FHA endorsement is a condition of payment of FHA insurance on that loan. HUD-FHA paid insurance claims, and incurred losses, on the Covered Transaction that were falsely certified as eligible for HUD-FHA insurance. By reason of the foregoing, the Government has been damaged in a substantial amount to be determined at trial, and is entitled to treble damages and a civil penalty as required by law for each transaction.

THIRD CAUSE OF ACTION

Negligence

193. The Government incorporates by reference paragraphs 1 through 174 as if set forth fully herein.

194. On June 30, 2011, Cliff Cole of HUD's Headquarters, using the methodology implemented by the Office of Inspector General ("OIG"), flagged 26 of Reunion's defaulted loans for review. HUD OIG began reviewing those files on October 25, 2011, and uncovered the fraudulent

1 conduct described above.

2 195. Prior to June 30, 2011, no responsible government official knew or reasonably should
3 have known of the facts constituting Reunion's negligence.

4 196. Reunion owed the Government a reasonable duty of care and a duty to conduct due
5 diligence.

6 197. As set forth above, through Reunion's individualized loan certifications and the annual
7 certifications necessary for Reunion to retain DEL status, both , breached their duties to the
8 Government.

9 198. As a result of Defendants' breaches of their duties, the Government paid insurance
10 claims, and incurred losses, relating to HUD-FHA insured mortgages approved by Reunion.

11 199. By virtue of the above, the Government is entitled to compensatory damages, in an
12 amount to be determined at trial.

13
14 **FOURTH CAUSE OF ACTION**

15 **Payment by Under Mistake of Fact**

16 200. The Government incorporates by reference paragraphs 1 through 174 as if set forth fully
17 herein.

18 201. The United States seeks relief against Reunion to recover payments made under mistake
19 of fact.

20 202. On information and belief, Reunion submitted, and HUD-FHA paid, \$1,630,527.89 in
21 insurance claims on the defaulted Covered Transactions that Reunion falsely certified were eligible for
22 insurance.

23 203. HUD-FHA made payments to Reunion under the mistaken belief that the defaulted
24 Covered Transactions had been eligible for HUD-FHA insurance.

25 204. By reason of the foregoing, the United States has been damaged in a substantial amount
26 to be determined at trial.

FIFTH CAUSE OF ACTION

Breach of Fiduciary Duty

205. The Government incorporates by reference paragraphs 1 through 174 as if set forth fully herein.

206. HUD-FHA and Reunion have a special relationship of trust and confidence by virtue of Reunion's participation in the DEL program. The DEL empowered Reunion to obligate HUD-FHA to insure mortgages it issued without any independent HUD-FHA review. Therefore, Reunion were in a position of advantage or superiority in relation to HUD-FHA and is a fiduciary to HUD-FHA.

207. As a fiduciary, Reunion had a duty to act for, and give advice to, the Government for benefit of the Government as to whether mortgages should be insured by HUD-FHA under the DEL program.

208. As a fiduciary, Reunion had an obligation to act in the utmost good faith, candor, honesty, integrity, fairness, undivided loyalty, and fidelity in its dealings with the Government.

209. As set forth above, Reunion breached their fiduciary duty to HUD-FHA.

210. As a result of Reunion's breach of fiduciary duty, HUD-FHA has paid insurance claims and incurred losses.

211. By reason of the foregoing, the Government is entitled to compensatory damages in an amount to be determined at trial.

SIXTH CAUSE OF ACTION

**Federal Debt Collection Procedures Act
Fraudulent Transfer - 28 U.S.C. § 3304(a)**

211. The Government incorporates by reference paragraphs 1 through 182 as if set forth fully herein.

212. This is a fraudulent transfer action under 28 U.S.C. § 3304(a)(1).

213. Reunion made each of the transfers described in paragraphs 180 and 181, above, to Mr. Thayer and Mr. Harvey, without receiving a reasonably equivalent value, as defined in 28 U.S.C. § 3303(b).

214. The transfers to Mr. Thayer and Mr. Harvey were made after the debt to the United States

1 arose and intentionally hindered, delayed or defrauded the United States, as creditor. 28 U.S.C. §
2 3304(b).

3 215. Reunion was insolvent, as defined in 28 U.S.C. § 3302, at the time of the transfers or was
4 made insolvent as a result of the transfers.

5 216. The United States seeks avoidance of the transfers to the extent necessary to satisfy
6 Reunion's debt to the United States. 28 U.S.C. § 3306(a)(1).

7 217. The United States seek a judgment for the value of the assets transferred, not to exceed
8 Reunion's debt to the United States.

9 **SEVENTH CAUSE OF ACTION**

10 **Federal Debt Collection Procedures Act**
11 **Fraudulent Transfer - 28 U.S.C. § 3304(b)**

12 218. The Government incorporates by reference paragraphs 1 through 182 as if set forth fully
13 herein.

14 219. This is a fraudulent transfer action under 28 U.S.C. § 3304(b)(1)(B).

15 220. Reunion made each of the transfers described in paragraphs 180 and 181, above, to Mr.
16 Thayer and Mr. Harvey, without receiving a reasonably equivalent value for the transfer.

17 221. At the time of the transfer in December 2011 through April 2012, Reunion should have
18 reasonably believed that it did not have the ability to pay its debts as they became due.

19 222. The United States seeks avoidance of the transfers to the extent necessary to satisfy
20 Reunion's debt to the United States. 28 U.S.C. § 3306(a)(1).

21 223. The United States seek a judgment for the value of the assets transferred, not to exceed
22 Reunion's debt to the United States.

23 **PRAYER FOR RELIEF**

24 WHEREFORE, the United States demands judgment against Defendants as follows:

25 a) On Counts One and Two (False Claims Act), judgment for the Government against
26 Reunion, treble the Government's damages, and civil penalties for the maximum amount allowed by
27 law;

28 b) On Counts Three, Four, and Five (Negligence, Payment Under Mistake of Fact and
Second Amended Complaint CV 13-2340 SBA

1 Breach of Fiduciary Duty), judgment for the Government against Reunion and compensatory damages
2 including prejudgment interest, making the Government whole for past losses;

3 c) On Count Six and Seven (Federal Debt Collection Procedures Act), judgment for the
4 Government against Defendants that pursuant to 28 U.S.C. § 3304, the transfers by Reunion to Mr.
5 Thayer and Mr. Harvey between December 2011 and April 2012 are null and void and that those assets
6 are deemed property of Reunion and encumbered by the judgment for the United States and/or that Mr.
7 Thayer and Mr. Harvey are indebted to the United States for the transferred amounts.

8 d) For an award of costs pursuant to 31 U.S.C. § 3729(a) and

9 e) For an award of any further relief as the Court shall deem just and proper.

10 Dated: December 4, 2013

11 Respectfully submitted,

12 MELINDA HAAG
13 United States Attorney

14
15 _____/s/_____
16 ILA C. DEISS
17 Assistant United States Attorney

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19 Attorneys for United States of America
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